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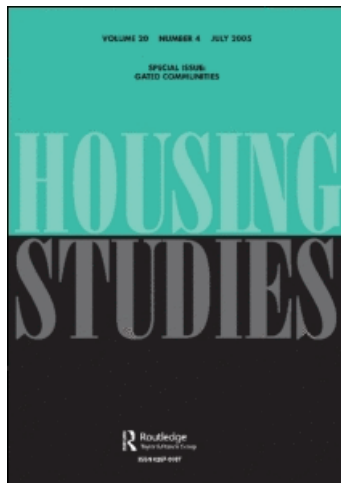
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Housing Finance Trapped in a Dilemma of Perceptions: Affordability Criteria for the Urban Poor in India Questioned

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ABSTRACT *This paper demonstrates how formal housing finance is the product of the perceptions that prevail among the middle and upper classes, who as policy-makers, economists and managers, determine how housing finance institutions fix the terms and conditions of housing loans for the urban poor. They use affordability criteria that fit the purchase or construction of a house in one go. However, affordability criteria for the urban poor have to be linked with practices of incremental building and consequently incremental financing. Failing to do so leads to serious mismatches between the demand and supply of formal housing finance for the urban poor. To be able to serve the poor adequately, the middle and upper classes should stop aiming at the financing of housing constructed in one go. Instead, they should open their minds to the building and financing practices of the urban poor.*

Introduction

In order to serve the Indian urban poor, affordability criteria for providing housing loans are used by the private and public housing finance sector. However, at the roots of affordability criteria different perceptions concerning the construction and the financing of housing can be traced among different groups in society. Middle and other upper classes are inclined to construct complete housing units in one go, while the urban poor tend to build their houses step by step. The construction of complete dwelling units requires large housing loans, often associated with a long repayment term. Incremental building requires incremental financing—relatively small loans preferably with a short to medium term. Incremental building and financing can function as a vehicle for economic progress for the urban poor. Large housing loans to be repaid over the long term, however, jeopardise this economic progress and can even worsen the living conditions of the poor. As long as the middle and other upper classes working in formal housing finance institutions are not aware of the notions of the urban poor regarding building and financing, the poor will not be helped at all. There is a need to change the official perceptions of how the poor should build and finance their dwellings, which could also improve the

recovery of the loans. The next step has to be an adjustment of policy; otherwise there will be a serious mismatch between the applied and required affordability criteria concerning housing finance for the urban poor. Moreover, it will be shown that it is possible to finance dwellings for the poor without seriously jeopardising their survival strategies.

This paper first looks at affordability criteria. Second, the concepts of incremental building and incremental financing will be discussed. Third, the survival strategies of the urban poor will be dealt with. This will be followed by a description of public and private housing finance for the urban poor in India. Finally, an attempt will be made to break away from perceptions concerning housing finance which are suitable only for the dominant middle and other upper classes, and alternative ones will be proposed.

Affordability Criteria in a Nutshell

The living conditions of the urban poor in developing countries are generally characterised by substandard shelter and unhealthy neighbourhoods. Initially, policies dealt with ready-made housing and the construction of houses based on self-help. Gradually the focus shifted to include the land issue and housing finance. Efforts are made to reach the urban poor with formal housing finance, but the poor are only reached with great difficulty, if at all. Even if the efforts appear to be successful, cost recovery remains problematic, for which the urban poor are often blamed.

In this respect, the concept of affordability is of crucial importance. Housing finance will only be provided if the lender is largely sure the loan will be repaid. The affordable size of a housing loan is generally determined by taking into account the capital costs required, its financing terms, the size and regularity of the household income and physical possessions, and the propensity to consume housing. Conventionally it is thought that if the capital costs, financing terms and household income are known, the propensity to buy housing or the willingness to invest in the dwelling will follow automatically (Lee, 1990, p. 64). Hancock (1993, p. 129), by referring to Bramley, is more specific and states that housing is only affordable for households if after deduction of the housing costs—rent or repayment of a housing loan—sufficient means are left over to provide the necessities of life without falling below the poverty line. A typical house can be made affordable by means of subsidy. However, this option is rather limited for Third World cities due to the scale of their housing problems and a shortage of financial means.

Apart from viewing affordability as an income problem, it can also be seen as a housing market problem. First, government intervention tends to be geared towards adjusting the denominator of the rent-to-income ratio. If housing affordability is considered a market problem, it refers to a government role concerning the physical provision of housing (Linneman & Megbolugbe, 1992, p. 387).

Discussions about affordable housing are not a new phenomenon; they started at the end of the 19th century and the beginning of the 20th century in the so-called Western world. It was stated that 'one week's pay for one month's rent' could be afforded. Later on, mortgage lenders started using a housing expenditure-to-income ratio, which more or less assumes how much an average household is able to spend on housing, which is a maximum 25–30 per cent of their

income. These ratios, in fact rule of thumb measures, are used for various purposes. They can be used for describing a typical household expenditure pattern, for analysing administrative rules for allocating subsidies, defining housing needs, public policy purposes, predicting the ability of a household to pay rent or to repay a mortgage loan, and selecting households for a rental unit or a mortgage loan. However, these ratios are increasingly criticised, because of the inaccuracy of defining the actual income of a household and predicting the willingness of the beneficiaries to allocate a specific part of their budget for housing. In reality, households can be traced which spend more on housing loans than the ratio indicates (Hulchanski, 1995, pp. 471–484). Despite the history of conceptual, theoretical and methodological errors in relation to affordability ratios they are still in use. Hulchanski therefore suggests that it is crucial to look into the usage of affordability criteria and what their focus should be in a specific context such as urban India.

Affordability is also of crucial importance for urban India. In 1991 India's urban population was 217 million and had doubled in size since 1971. The urban population is expected to increase by at least 3.5 per cent per annum, which will be reflected in a further expansion of the urban area and population. This population growth has and will continue to put enormous pressure on housing, the urban infrastructure and the administration, leading to a shortage of housing and basic facilities. Particularly those living below the poverty line (40 per cent of the urban population in 1987–88) face problems of access to existing housing and basic facilities (Repetto, 1994, pp. 57–64). The housing agencies "have not taken into consideration the demand pattern and affordability of different sections of the population, particularly those in the lower income strata, in designing the housing projects. On the other hand, several of these agencies, by their very mandate and the financial and administrative stipulations guiding their activities, have explicitly excluded the poor" (Kundu, 1993, p. 62). In the meantime, attempts are being made to provide the poor with affordable housing finance.

Incremental Building and Incremental Financing

Incremental building is the process through which shelter is constructed step by step. Over a period of time the dwelling will be improved in quality and/or size. Such incremental building activities are dependent on the individual household priorities and the means available, and change according to the family cycle or changes in the life of migrants in the city. As people change continually throughout their lives, so do their household needs, priorities and possibilities. In recent decades, incremental building has been taken increasingly seriously as a successful method by which the urban poor can construct their homes. As an example, the World Bank took this idea by Turner (e.g. 1968, 1972), more or less seriously by incorporating some incremental building principles into their urban lending programme in the 1970s that resulted in, for example, sites and services pilot projects (see e.g. Gilbert, 1994, pp. 140–141; Nientied & van der Linden, 1988).

Very often, however, the implications of incremental building for housing finance are not worked out in detail. For instance, a World Bank policy paper only indicates that "small-scale mutual credit institutions and alternative lending instruments attuned to the needs of households undertaking incremental house-

building, should be encouraged" (World Bank, 1993, p. 122). However, it has to be realised that incremental building requires smaller loan amounts and often a shorter repayment term. Most conventional bankers are, however, hesitant about dealing with such types of loans due to, for example, their high overhead costs, and their unfamiliarity with the urban poor as clients. The main exceptions are the so-called 'people's banks' and most informal financial arrangements. In this respect, Merrett & Russell (1994, p. 61) write: "non-conventional finance can be defined as credit for the self-build process which does not share these characteristics of conventional finance". As yet there is no agreement among conventional financial institutions about the fact that incremental building requires methods of incremental financing (smaller loans with a preferable short to medium term). Malpezzi (1994) has taken the concepts of incremental financing for incremental building more seriously. He argues that

... very few households approach housing other than incrementally, in the sense of paying for their housing in parts, whether rich or poor households in rich or poor countries. What is desirable is to divorce incremental payment from incremental consumption, so that households can consume their desired bundle, or closer to it, sooner. ... The existence of financial and rental intermediation implies that consumption decisions can be made less dependent on current income and more dependent on long run ('permanent') income, and long run desired consumption. What is required, then, is the collateral development of housing finance and of private rental markets as the construction market moves downmarket. (Malpezzi, p. 459)

In other words, Malpezzi argues that decisions concerning the construction of shelter would become more efficient if financial decisions could be separated from building decisions (production of shelter). This would open opportunities for building and consuming now and paying for it later. This means that a (potential) house owner who has taken out a housing loan, constructs or buys a house and enjoys its benefits as soon as possible or even directly. Paying for it later takes the form of repaying the housing loan. In the case of tenants, others will build the house and rent should be paid as long as they are living in the house concerned. Tenants and house owners start consuming immediately and generally have to pay for it over a long period of time. Malpezzi suggests that it is better to enjoy the benefits of a complete housing unit now instead of consuming it incrementally and enjoying more or less the same benefits sometime in the future. This is possible because all income groups pay incrementally for their shelter. The notion that incremental building should be divorced from incremental financing, and the feasibility of renting for the poorest sections of society, will be challenged in this paper.

Incremental Building and Financing as a Survival Strategy

The material used in this section was gathered in 1993–94 in 13 slums, where no housing schemes have been initiated, in the twin cities of Hyderabad and Secunderabad (subsequently referred to as Hyderabad). In these neighbourhoods, a survey was carried out by interviewing households that were selected by requesting the co-operation of a person whose household lived behind a door facing the street. When co-operation was refused the next door was tried until

we succeeded, even if we had to pass several doors. After completing an interview the fifth door was selected for the next interview. The information gathered through questionnaires was supplemented with information from local leaders, financial agents and informal talks. In 1996 some households were revisited. For a more elaborated discussion see Smets (1996).

First, there should be some clarification about what is meant by the 'urban poor'. The Indian 'urban poor' can be distinguished as the so-called Economically Weaker Sections (EWS) with a monthly household income of less than Rs. 1250 and the Low Income Groups (LIG) with a household income of Rs. 1251–2650 a month (one Indian Rupee (Rs.) equals US\$0.033 (1993–94)).

The urban poor have developed survival strategies, by which is meant, broadly, "the ways in which poor households organise their production and consumption activities to guarantee the maintenance of their members" (Chant, 1991, p. 26). While survival strategies do not imply that actors always make rational choices, these strategies give an indication of how the poor in distress cope with the challenges within their household against the background of their poverty (De Wit, 1993, p. 21). The strategies that are used by some for sheer survival can be used by others to improve their living conditions. Such strategies have become mobility strategies or what Streefland (1989, p. 24) calls "modes of improvement". Compared with mobility strategies, survival strategies encompass a lower diversity of activities, a shorter time horizon of planning and a smaller income (Schmink, 1984, pp. 90–91).

For the context of this paper different kinds of survival can be distinguished: physical, psychological, and socio-economic survival, which may in various ways be interdependent. Physical and psychological survival are mainly individual and deal with continuity of life under sometimes severe circumstances and challenges threatening life such as in refugee camps and in famine-stricken areas. Socio-economic survival encompasses the struggles of individuals or households to maintain a certain position in society, for which relationships in that society must be maintained. This form of survival is more clearly embedded in social relations (Streefland, 1989, pp. 22–28). Survival strategies may differ within the same household because the personal needs of some members of the household may conflict with the overall needs of the household. Furthermore, these strategies may differ among different households, because they are dependent on the amount and regularity of income, size of the household, age of the household's members, changes in migrant's life, etc. However, some general characteristics can still be given. The poor try to finance their essential needs such as food, clothes and shelter from their own (financial) means, from credit or from social security mechanisms. Such credit is often obtained from the informal sector, with "all financial transactions, loans and deposits, occurring outside the regulation of a central monetary or financial market authority" (Adams & Fitchett, 1992, p. 2). However, people who are dependent on survival strategies try to avoid debts as much as possible and when they incur debts they opt for keeping their period of indebtedness as short as possible to be able to cope with other pressing needs such as food, education of the children, travel to the place of work and medicines. Ultimately, "repeated short-term loans enable the borrower to adjust periodically the outstanding debt to available household income, so that the debt/income ratio is not excessive" (Merrett & Russell, 1994, p. 64). An example will be given below of a short-term shelter improvement strategy of a typical poor female-headed household in Hyderabad:

Table 1. Expenditure priorities of slum dwellers in Hyderabad

Items of priority		Total
Priority 1	food (85%), rent (9%)	94%
Priority 2	clothing (29%), food (13%), rent (13%), education (12%), loan repayment (7%), medical care (5%)	79%
Priority 3	clothing (20%), medical care (18%), education (12%), loan repayment (9%), rent (7%)	66%
Priority 4	medical care (18%), clothing (13%), education (11%), networking (9%), loan repayment (7%), saving (6%), personal expenses (5%)	69%
Priority 5	medical care (12%), saving (10%), networking (8%), shelter (8%), clothing (7%), education (6%), loan repayment (6%)	57%

Source: own research (*n* = 230, missing cases 14)

A woman of 35 years old and her four children (two boys of 12 and 7, and two girls of 9 and 4) live in a hut. She survives by begging while carrying around pictures of several Hindu Gods. Daily she collects Rs. 7–8, which is scarcely enough to buy a daily portion of rice. Their hut is built on a piece of land squatted on when her husband was still alive. In 1994 the hut was partly washed away by the rains, but was rebuilt with the help of five neighbours, who were willing to do the work for relatively little; [they received] tea in exchange. Luckily enough she was able to buy from them some second hand bamboo mats to construct some temporary walls. These mats cost Rs. 350, which has to be repaid in a lump sum within a period of two months. For that purpose she has a cloth in which she puts a few rupees every day. The expectation is that when the means are available, mud walls will be constructed again.

Obviously not all households and their members have the same needs and priorities. Consequently, people do not automatically spend their surplus, if available, on shelter and they take decisions in accordance with a short-term planning framework.

To obtain more detail about the spending behaviour of slum dwellers in Hyderabad, the respondents were asked to give a list of items in order of priority. For an overview of these priorities see Table 1. In the interest of clarity only items with a minimum score of 5 per cent are included. This explains why the last column does not include a total score of 100 per cent. Table 1 also shows that the priorities set by households differ. In this respect, it is remarkable that investments in shelter are only mentioned as their fifth priority by 8 per cent of the households interviewed. Rent payments have a much higher priority (9 per cent as first priority, 13 per cent as second priority and 7 per cent as third priority). The loan repayments reported concern non-housing loans, which have a higher priority than investments in shelter.

To illustrate this overview of expenditure priorities, an example follows of the spending behaviour of a household where husband and wife co-operate in financial matters. Here, both are eager to make decisions concerning their expenditure by mutual agreement. In this household the following in order of priority was traced:

- (1) food,
- (2) medical expenses,

- (3) education of the children,
- (4) receiving relatives/visiting relatives,
- (5) clothes.

The fourth priority needs some further explanation. Receiving and visiting relatives requires investment in food, drinks and possibly gifts. Investment in these relationships is of crucial importance for the poor to secure help in the event of an emergency.

When credit is taken out, the repayment often takes first or second priority. This implies that the other priorities will be pushed down the list. It should be realised that the list of priorities is not as rigid as it may seem. On each item it is possible to economise to be able to cope with other expenditures, but these opportunities are rather limited. In order to meet other needs the poor opt for a short period of indebtedness. For this period other pressing needs can be postponed until the debt is repaid. For the same reason the poor prefer to live in rent-free shelter, even when the only remaining option is to live in very poor accommodation to avoid long-term deduction from their income, which reduces the opportunity of meeting other needs. A street hawker in Hyderabad explained it as follows:

We could not afford to pay rent because I did a job on a temporary basis.

Thus, the poor try to secure their survival in the future by maintaining their flexibility as much as possible. Obviously the management of the household budget becomes more problematic when one of the household members, often the male, does not take responsibility for the household and prioritises his personal expenditures by visiting cinemas, drinking liquor, or smoking cigarettes. The consequences of such selfish behaviour are illustrated by the words of a female slum dweller in Hyderabad:

My husband is a guide for lorry drivers in the city. I do not know how much income he gets. I get Rs. 200 a month from him (which is far less than his income). He drinks too much. So I have to wash up at houses nearby. They pay me Rs. 200 a month. Furthermore, I have to do my housework and look after my four children. I face a lot of problems.

In terms of daily expenses the poor have short-term perspectives, which are also mirrored in their investments in shelter. These investments are needed for land, building materials, tools and construction skills. If these elements are not at hand they can be obtained through exchange or purchase. The limited means available force the poor to build their houses a little at a time, which is one of their survival strategies. In this way shelter becomes affordable for them. By building and improving their shelter when it is considered convenient, the poor generally try to improve their living conditions as will be illustrated by the following example of a household, classified as being from a low-income group.

In 1994, Ramesh, a low-grade government employee, lived together with his wife Radhika and three children in government quarters for which Rs. 500 was deducted from his salary of Rs. 2300. He also worked as an agent for the Peerless Finance and General Investment Company and could make an additional Rs. 200–300 a month. In 1992 he illegally bought a 160 square yards plot of land on the outskirts of

the Hyderabad for Rs. 12 000. This was financed by interest-bearing loans (total Rs. 6000) from friends. The remaining amount was saved through a *chit fund* (ROSCA). The *chit fund* in which Ramesh participates is an auction ROSCA (rotating savings and credit association) for which he has to pay a monthly fixed contribution for a determined period. All participants pay a monthly fixed amount to the kitty and will obtain the common fund once during a cycle. During meetings participants have to bid for the fund by offering the highest discount on the kitty. This deducted amount will be divided among all participants and the receiver of the fund obtains the remaining amount. Once a participant has received the kitty, he is not allowed to partake in subsequent bidding activities.

In 1994 the family decided to move to a rented dwelling near their plot, for which they had to pay Rs. 100 monthly. From this house without electricity, water and sanitation they could keep an eye on their plot and prevent occupation by others. In the mean time, Ramesh saved through a *chit fund* and could allocate the rent allowance that earlier had been deducted from his salary to contributions in a *chit fund*. After having accumulated enough funds the construction of his own dwelling took place between February and October 1995. It is a concrete house with two small rooms and a very small kitchen. A wall surrounds the plot and a bathroom and toilet were constructed on the premises. The total costs were Rs. 100 000. The financial sources were an advance of Ramesh's provident fund (Rs. 20 000), Rs. 30 000 and Rs. 9000 from two different *chit funds*, and two loans of Rs. 10 000 each from two of Ramesh's sisters. He borrowed a total of Rs. 10 000 from colleagues and two loans of Rs. 5000 were taken out from moneylenders. For the repayment of the loans savings will be accumulated in a *chit fund*. Once the fund is obtained the loan will be repaid. As soon as the construction activities started Ramesh stopped his job with Peerless and the family started selling chicken meat in the backyard of their house. Ramesh said that a further extension of the house would be postponed until all loans are repaid and the marriage of their daughter has been financed. In the meantime Ramesh is thinking of renting out a part of his plot to a school which recently started up in the neighbourhood.

An incremental way of building opens opportunities for converting the survival strategies of the poor into mobility strategies. The implication of this is that the shelter of the urban poor should not be judged solely by present physical appearance, but by what each potentially means for its users (Turner, 1976, p. 61). Shelter can have several meanings for the urban poor. An urban dwelling may serve as a substitute for status derived from the possession of material (e.g. cattle, tools and irrigation facilities) or ancestry symbols (Alcock *et al.*, 1963, p. 85). It can also serve as collateral for credit from, for example, moneylenders, pawnbrokers, relatives, friends, and neighbours. A slum dweller in Hyderabad explained it as follows:

If he (the moneylender) does not know us and our house, he will not provide a loan. Even if we want to pawn a golden ornament, he will be hesitant in accepting it if he does not know that we are living in our

own house. This will give him some guarantee that the ornament is not stolen. If it is stolen he may get problems with the police. Then he can easily find us and take action.

The importance of being an owner occupant to obtain a loan more easily is also illustrated by van der Linden (1983, p. 73) who quotes a slum dweller in Karachi:

Everybody around us knows that I have spent Rs. 3000 on this house. So my neighbours know that I would not run away, and when my wife had to be admitted to the hospital, I could borrow from my neighbours.

Furthermore, the urban poor are often refused as participants in a *chit fund* if they are not owner occupants. The security function of the dwelling is especially important for the poor when traditional means of social security such as local networks based on kinship, are eroded and access to institutionalised security is lacking. The security derived from one's own dwelling is minimised if the shelter concerned is under long-term financial obligations. For migrant squatters the house often serves as a source of socio-economic security, enabling help from slum dwellers and participation in community-based organisations. The reasons mentioned above and the earlier mentioned avoidance of long-term financial obligations explain why the poor prefer to have their own dwelling, even when it is a hut or shack, instead of renting one. Tenants do not have the house as security and may run away after having taken out an informal loan.

Variable income and a flexible expenditure pattern mean that no indication can be given of what proportion of their income poor people can, and are willing to, spend for their habitat (Turner, 1976, p. 37). In general, credit taken out by the urban poor is for relatively small amounts, for a short or medium term and with high interest rates. It could be suggested that borrowers are prepared to pay a high rate of interest when they can get access to quick and flexible financial services (Holt & Ribe, 1991, p. 16). The focus of the paper will now shift to formal housing finance for the urban poor.

Formal Housing Finance for the Urban Poor in India

In India, formal housing finance can be provided through public or private institutions. Examples of public and private housing finance for the poor in Hyderabad will be discussed. Public housing finance encompasses project finance, while private housing finance refers to individual as well as project finance.

The material used for the analysis of public housing finance was gathered in seven slums in Hyderabad, where EWS schemes had been implemented or were still under implementation. The methods used are similar to those mentioned in the previous section. Moreover, interviews took place with employees of the national agency, the Housing and Urban Development Corporation (HUDCO), the Municipal Corporation of Hyderabad and the Housing Board and the Andhra Pradesh Urban Development & Housing Corporation. For a more detailed analysis of the public housing schemes, see Smets (1995).

The material in this section on private housing finance is based on interviews with employees of the Housing Finance Corporations in Hyderabad (HDFC, Canfin Homes Ltd., LIC Housing Finance Ltd., Dewan Housing Finance Development Ltd., GIC Housing Finance Ltd., AB Homes Finance Ltd., Vysya Bank

Table 2. Composition of the unit costs

Loan	Rs. 11 700
Subsidy	Rs. 1 000
Beneficiary contribution	Rs. 300
Minimum additional investments required	Rs. 5 000
Unit costs	Rs. 18 000

Housing Finance Ltd., Fairgrowth Home Finance Ltd.), and the head office of the HDFC in Bombay. Discussions with NHB staff in New Delhi also took place. This is supplemented with information collected from leaflets from the financial institutions concerned and (un)published literature. Parts of this section are taken from Smets (1997).

Public Housing Finance

Public housing finance for the urban poor is provided by HUDCO for the implementation of housing schemes for various income groups, such as the Economically Weaker Sections (EWS). In reality many Low-Income Group (LIG) households could be traced in the EWS housing scheme houses. In Hyderabad the Andhra Pradesh Urban Development and Housing Corporation (APUD & HC) and the Municipal Corporation of Hyderabad implement the EWS housing schemes.

Nowadays, only multi-storeyed buildings are built through the EWS housing schemes in Hyderabad, for which sufficiently strong foundations and pillars are required. If the beneficiary lacks construction skills labour has to be employed. After completion of the shell structure the house has to be completed by means of self-help.

To keep the unit costs of an EWS house low, land is provided free to the beneficiaries and some building materials are subsidised. Furthermore, the state government of Andhra Pradesh provides a subsidy of Rs. 1000 to the beneficiary after completion of the house. However, before a beneficiary can participate in an EWS housing scheme an admission fee of Rs. 61 has to be paid. Later, the housing loan of Rs. 11 700 is provided and secured by mortgaging the title deed. The credit bears a subsidised interest rate of 10 per cent p.a. and has to be repaid in monthly instalments of Rs. 98 over a period of 20 years. The housing loan is made affordable for the poor by subsidising the interest rate and lengthening the term to 240 months. The government has fixed the unit costs at Rs. 13 000, but also state that at least Rs. 5000 is required to complete the housing unit. In other words, the officially determined unit cost of Rs. 13 000 is far too low. For an overview of unit costs see Table 2.

The recovery of the government loans is very poor. For urban and rural Andhra Pradesh the recovery performance of the housing loans was 5.1 per cent of the total amount due up to 1992–93 (GAP, 1994, p. 55). For 1993–94 the recovery rate of the Municipal Corporation of Hyderabad varied from 7.04 to 15.86 per cent. One cause of this low recovery rate is that the EWS housing schemes are highly politicised. Houses are allocated through politicians, while other officials are responsible for the recovery of the housing loans provided. Politicians encourage the beneficiaries, who often do not belong to the target group, to refrain from repaying the loan. In this way vote banks are created and

maintained. Politics is not the only cause of the poor repayment record. The beneficiaries give a higher priority to repaying the private housing loans, which are needed to finish their houses in an EWS housing scheme. The finance for the additional investment of at least Rs. 5000 for completing the house has to be covered by savings, gifts from friends and relatives, credit from friends, relatives and moneylenders or derived from savings and credit associations. In practice, these sources of finance are used alone or in combination with one another. Moreover, the concept of affordability as used in this scheme may be questioned, and can be illustrated by complaints that were commonly expressed by beneficiaries in Hyderabad.

My hut was good. When we were living there it was good. When the scheme started we were surrounded by loans.

Why did I have to leave my old house, which had mud walls and an asbestos roof? When I was living in it, I was happy. Now I have a nice house but I am terribly in debt. How can I get my children married with all these loans outstanding?

It appeared that the poor have different priorities from the policy-makers. The urban poor consider flexibility in their expenditure pattern of greater importance than living in a 'beautiful' house which makes them indebted for a long period.

Private Housing Finance

Private housing finance corporations are promoted, regulated and supported by the National Housing Bank (NHB). The NHB aims to mobilise household savings through promoting savings-linked housing finance schemes, facilitating access to institutional housing finance, and increasing the supply and improving the use of scarce land and building materials (NHB, 1990, pp. 1–4). According to the NHB guidelines and directions, housing finance corporations have to focus primarily on the provision of housing loans for the construction or purchase of residential houses in India. Credit for the enlargement or repair of houses has to be a minor activity. Moreover, lending has to take place on terms and conditions considered adequate by the housing finance corporations within the framework set by the National Housing Bank. According to the framework, the interest rate is dependent on the size of the individual loans and not directly on a specific target group. Housing finance corporations may charge a maximum interest rate of 12 per cent p.a. for credit up to Rs. 25 000 and for loans from Rs. 25 001–100 000 a maximum of 14.5 per cent p.a. Housing finance corporations are free to fix the interest rate for loans above Rs. 100 000. The smaller housing loans are made cheaper by cross-subsidising the interest rate. The underlying assumption is that such credit will be affordable for the poor. Initial charges, excluding registration charges for documents and stamp duty, to a maximum of 2 per cent of a housing loan are charged to cover the overhead cost of checking the title deeds and administration costs (NHB, 1991, pp. 2–7).

Apart from the provision of individual housing loans, the NHB also finances public and private housing schemes. For an overview of the interest rates on public and private housing loans see Table 3. In slum redevelopment schemes incremental building on a low-cost basis is encouraged. For each unit, credit can be provided to a maximum of 80 per cent of the unit costs or Rs. 45 000. The

Table 3. Interest rates for loans with effect from 1 May 1994

Loan size	Interest rate p.a. charged by	
	NHB (refinance)	HFCs
For new units & those allotted NHB's land development and shelter projects		
up to Rs. 25 000	10.00 (fixed)	12.00 (maximum)
Rs. 25 00–100 000	14.25 (fixed)	15.50 (maximum)
Rs. 100 000–200 000	14.25 (fixed)	*
For upgrades		
up to Rs. 30 000	14.25 (fixed)	15.50 (maximum)
Project loans		
public agencies	15.50	16.50
housing co-operatives	15.50	16.50
rental housing	17.00	18.00
professional developers	17.00	18.50

Note: * HFCs are free to decide the interest rates for these loans.

credit, with a term of 15 years, requires the mortgaging of the property or a government guarantee. Table 4 provides an overview of the interest rates in effect for credit for slum redevelopment schemes. In practice, housing finance for the EWS schemes in Hyderabad only comes directly from HUDCO, because the project loans from the housing finance corporations are considered too expensive.

Housing finance corporations are encouraged to serve the poor through the refinancing facilities of the NHB, who can provide credit to a housing finance corporation after it has provided specific loans to the poor. Recognised housing finance corporations, who provide credit for the purchase of a new house with a built-up area of a maximum of 40 square metres or a maximum of Rs. 150 000 for costs, including land, can claim refinance from the NHB. Furthermore, credit up to Rs. 30 000 can be completely refinanced if it is to be used for upgrading a house (NHB, 1991, p. 8). Refinancing will take place at a lower interest rate than the rate charged by the housing finance corporations. The National Housing Bank levies 1.25 to 2 per cent less than the maximum interest rate charged by the housing finance corporations for that specific loan. For example, individual housing loans up to Rs. 25 000 can be refinanced at 10 per cent p.a., which is 2 per cent below the 12 per cent p.a. charged by the housing finance corporations. This difference is the profit margin for the housing finance corporations on such a housing loan. The term of the loans is 5–20 years and the average loan:value ratio is 51–75 per cent (Struyk & Ravicz, 1992, p. 76). The remaining amount has to be paid by the beneficiary himself.

Table 4. Interest rates for shelter improvement in a slum redevelopment scheme with effect from 1 May 1994

Loan size	Interest rate
up to Rs. 25 000	9%
Rs. 25 001–Rs. 45 000	12%

Housing finance corporations are not very eager to provide small loans. Smaller loans require higher overhead costs while the prescribed interest rate is smaller. On account of the small or even negative profit margin, the provision of small loans is not at all popular among housing finance corporations who are not very eager to provide them and tend to keep to larger loans, which are meant for the better off. In relation to the poor, housing finance corporations make use of unsuitable credit terms and conditions, such as relatively long-term credit, and tight methods of repayment. Furthermore, the methods of repayment often conflict with the repayment capacity of the poor, which requires some flexibility to overcome periods in which their income drops too much, such as happens to street hawkers during the rainy period.

The access of the poor to housing finance corporations is often constrained by high transaction costs for the borrower, such as transportation costs to and through the housing finance corporation offices, and paperwork expenses. Even when housing finance corporations are located near the residences and work places of the poor, their financial systems are not sufficiently tailored to the poor. Participation in a housing-linked contractual savings scheme does not ensure a housing loan will be obtained. Participants with home loan accounts have to deposit savings for a period of five years before being eligible for a housing loan. However, they still have to prove their capacity to repay in conventional ways. Apart from difficulties in measuring their repayment capacity, the urban poor face other problems in obtaining a housing loan due to, for example, lack of a marketable title deed for a plot of land and lack of regular and high enough income.

Housing Finance for the Poor: An Attempt to Break Out of the Trap

Public and private housing finance for the urban poor, as described in the examples, is characterised by mortgage lending, subsidised interest rates, mainly long-term finance, and repayment in equal monthly amounts. The housing loans are provided to buy a complete dwelling or to construct one. In public sector housing schemes an incremental method of building is incorporated, but the ultimate aim is the construction of a complete housing unit, as designed by the municipal corporation of Hyderabad. Here it is expected that the beneficiaries will have to take out a large loan, whose size varies with the different income groups. To make such a unit affordable for the poor, direct subsidies on construction costs and/or indirect subsidies on the interest rate are involved. The formal housing loans are made affordable for the poor by lengthening the period of repayment by reducing the equated monthly instalments. However, the implicit assumption is that the income and intention to pay for housing remains the same during the long period of indebtedness (Lee, 1990, p. 67).

The affordability criteria used by the Indian private housing finance sector are based on minimum income criteria in order to be able to exclude lower-income groups. The Indian public housing finance sector affordability criteria are based on maximum income criteria to cut off higher-income groups from specific housing and housing finance. In this respect, Hulchanski (1995, p. 480) has traced similar differences in North America.

For individual private sector housing loans, it is assumed that small loans with a subsidised interest rate will be taken out by the poorer sections of society. This would potentially enable a process of incremental building, but the housing

finance corporations are not very eager to provide these small loans because of their larger overhead costs and lower interest rate. Furthermore, the poor are considered to be a high risk because they generally lack marketable title deeds and a regular income that is high enough to pay off the loan. This encourages the housing finance corporations to focus on larger housing loans.

The informal financial sector serves those who are not satisfied with the services of the formal sector or those who have no access to these institutions at all. Informal finance institutions are often considered more efficient with regard to the speed of the transactions, the distribution of credit to many borrowers rather than a few, the rate of return offered on borrowed funds, the rate of recovery, and their services. Other advantages of the informal financial sector are the safeguarding of proper scrutiny of the loan application and collateral, personal assessment, and follow up action. Regarding the interest rates charged and the intermediary costs, the informal sector institutions are as efficient as banks (Nayar, 1992, pp. 202–207). Moreover, contrary to formal housing finance, informal housing finance is generally characterised by non-mortgage lending, but by lending that is mainly secured by social control mechanisms which are in practice effective alternatives for conventional collateral. In an urban setting the ownership of a dwelling, even a hut or shack without legal title deed, is required to ensure that people who still have financial obligations in a specific neighbourhood do not disappear. The interest rates for informal housing loans are relatively high (3–10 per cent per month is no exception) and the term is short to medium.

A popular financial instrument for incremental building is mutual financial institutions such as the earlier mentioned *chit fund*, or ROSCA. The ROSCA is “a poor man’s institution for accumulation of savings” (Nayar, 1992, p. 196), but not exclusively so. In addition to the flexible nature of the ROSCA and its short term, social control generally successfully encourages the savings behaviour of its participants. During a ROSCA cycle participants pool savings on a regular basis, and this common fund is allocated to each participant in turn. The ROSCA offers the opportunity to deposit savings and to obtain a lump sum once during a ROSCA cycle. The welfare of the participants will be raised by forming a ROSCA “because some financial intermediation reduces everyone’s utility cost of saving up” (Besley *et al.*, 1993, p. 797). ROSCAs operate with social collateral that replaces conventional collateral to a large extent. Social collateral can take the form of control mechanisms, which require face-to-face relationships. In an urban environment, people can more easily escape face-to-face contacts, which can be compensated for by being tied to a specific neighbourhood. Such ties require owner occupant status for the urban dweller, even when it concerns a shack. Defaulters are excluded from further participation. The ROSCA is very popular due to its flexible nature and the possibility of adjustment to the socio-economic, cultural, and financial needs of the participants in a specific environment. The disadvantage of ROSCAs is that participation in a ROSCA will only be accepted if some network is established, which requires the means to do so. Its implication is that the poorest of the poor will be excluded. Moreover, ROSCA participants generally cannot influence the moment when they obtain the common fund. In auction ROSCAs this problem is to a large extent solved by the introduction of bidding for the kitty. While auction ROSCAs are considered inferior to credit markets by Besley *et al.* (1993, p. 808), they are popular among

the poor, because their micro-finance nature fits their survival and mobility strategies.

The relatively small size of housing loans from the informal market match the habit of incremental building. Affordability is considered a dynamic concept, which enables the poor to build what and when they can afford it. Furthermore, this enables the extension and improvement of houses over time. In practice, a short or medium-term loan for an incremental building process better matches the way of life of the urban poor than a long-term loan for a complete housing unit. The repayment of a housing loan is dependent on the borrower's capacity and willingness to pay. In this respect, it appears that women show more responsibility concerning the repayment of loans (e.g. Moser, 1992, p. 90). The ultimate result of the incremental construction of a house may be that it is more expensive than the construction of the same unit all at once. Although presumably it helps, affordability does not mean that the credit should be cheap. It is more important that the credit can be handled. In other words, incremental building for the urban poor requires incremental financing. This contradicts Malpezzi's idea that incremental building and incremental financing should be distinguished from each other. When incremental building and financing are not linked, people can build a complete housing unit and enjoy the benefits immediately. Payments made for the repayment of the housing loan or rent enable the possibility of consuming now and paying for it later. However, with the construction of complete dwelling units large loans are involved leading to financial obligations over a long period of time. This is exactly what the poor try to escape from as much as possible. The urban poor opt for an incremental building process with only short or medium-term obligations. In other words, the poor opt for a link between incremental building and incremental financing. Here, incremental financing refers to the term of the loan, and not to the size of the instalments as Malpezzi suggests. Even when, for instance, more flexible repayments can be developed by allowing periods of non-payment, the long-term loan tends to jeopardise the survival strategies of the poor. Long-term loans prevent the poor from taking out loans for other purposes. An indebted house cannot provide its owner with the socio-economic security which enables the owner to obtain financial or non-financial help at some future date.

Housing finance institutions are risk averse and tend to invest in areas where they feel secure, which means they should know the target group. It appears that the poor as a market segment are not well known or are considered difficult to serve by private and public housing finance institutions. Serving the poor with housing loans is difficult as long as the perceptions of policy-makers, economists and managers of housing finance institutions conflict with the needs and perceptions and possibilities of the poor. There are several prejudices concerning the poor. It is believed that the poor cannot decide which type of loan suits them best and that the poor will overestimate their capacity to repay. Furthermore, the urban poor are illiterate and lack experience with the formal financial sector. However, the poor do have experience with finance (savings and credit), but this is restricted to the informal financial sector (Lee, 1990, p. 76) where they demonstrate perfectly rational behaviour. Breaking away from conventional wisdom and introducing incremental financing—or in other words micro-financing—can be seen as an attempt to break the barriers formed by the perceptions of middle and other upper classes. These perceptions determine the terms and conditions of housing loans and the actual release of these loans

from the formal housing finance institutions. Contrary to HUDCO, the policy of the NHB attempts to break down the barriers by encouraging incremental financing for an incremental building process. However, in practice, housing finance corporations are very hesitant about dealing with incremental financing, because the conventional criteria used for determining creditworthiness exclude the poor.

Conclusion

It can be said that formal housing finance is linked to long-term credit, unlike the short and medium terms in the informal sector. Long-term housing loans fit the housing construction practices and perceptions of the middle and upper classes. Dominant middle and upper classes, as beneficiaries, can more easily afford to build a complete housing unit and finance it to a large extent with long-term credit. Here, supply of and demand for housing finance do meet each other. The urban poor, however, build their dwellings according to an incremental building process, which requires short to medium-term credit. The provision of ready-made buildings with long-term credit or rent obstructs their mobility and their survival strategies, which encompass an avoidance of long-term financial obligations. The need for incremental building and financing is defined by the insecure living conditions of the poor. Here, income poverty does not necessarily lead to housing poverty if housing is built and financed incrementally.

The concept of housing schemes for the urban poor with long-term credit is not advisable. The danger of this mismatch between supply and demand is that the poor will not be helped at all, but rather that they will be pushed below the poverty line or even further below it. In addition, the poor are not necessarily helped by credit alone. They are helped by access to finance on terms they can manage. For the housing finance institutions the problem of screening the repayment of the loans provided to the urban poor can be solved by making use of social control mechanisms instead of conventional collateral. Social control mechanisms function especially well in group-based savings and credit associations such as ROSCAs. In short, housing finance is trapped in a dilemma of perceptions among the middle and upper classes, who as policy-makers, economists, and managers of housing finance institutions, determine how the housing finance institutions mainly fix the term and conditions of housing loans for the urban poor, and this must be challenged. The NHB's attempts at breaking open the trap and promoting incremental building and financing on a limited scale have not been successful. More efforts should be undertaken to demolish the trap completely, to enable the delivery of micro-housing finance to the poor.

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